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SUBJECT: SRI LANKA'S GDP GROWS 5.6% IN FIRST HALF OF 2003

¶1. Summary: The Sri Lankan economy recorded 5.6% GDP growth in the first half of 2003, coming mainly from industry and services. Other macro economic fundamentals have also improved, and contributed to strengthening of the Sri Lanka Rupee recently. The Central Bank says economic performance is within expectations and annual GDP growth could be higher than the original projection of 5.5% in 2003, though still not at the 8-9 percent range required for "tiger" status. End Summary.

Growth led by industry and services

¶2. GDP growth in the first half of 2003 was 5.6% compared with 1.4% growth recorded in the first half of 2002. The economy expanded strongly by 5.5% in the second quarter of 2003 despite severe flooding in the Southern and South Western parts of the country.

¶3. Industry and services were the main contributors to growth in 2003. Exports grew by a strong 18% to \$2.4 billion in the first half of the year. Driven by rising exports, the manufacturing sector grew by 5.4% compared to a 2.6% decline in the first half of 2002. Service sector growth was 7.2% compared to 3.1% during the same period last year. Communications, banking and insurance, and tourism led services growth. The construction industry grew by about 5%, while the agriculture sector declined 0.2% as fish production dropped sharply and severe floods during May damaged tea crops. Most other agricultural crops performed well, with rice reaching record production. According to the Central Bank, a 25% increase in cultivated area in the north and east consequent to the ceasefire has helped rice production.

¶4. Improved macroeconomic conditions, greater fiscal control and the continuation of the ceasefire between the Government and the LTTE have increased overall economic activity. Interest rates have dropped significantly. Currently, T-bill rates are around 7.25% compared with 11% a year ago. The commercial bank prime rate is 9.3% compared with 12.57% a year ago. Inflation is also trending down and is expected to fall to 6% from 9.6% in 2002. The economic upturn boosted the stock market to an all time high in September. Increased remittances, tourism, investment and aid/loan flows to the Government have helped boost total foreign reserves to \$2.8 billion (5.2 months of imports) as of July, up from \$2.5 billion in January 2003. This inflow of foreign currencies has led to a three percent appreciation of the rupee relative to the dollar.

5. On September 30, the Central Bank's Deputy Governor, W.A. Wijewardena, told the media that the bank was encouraged by the continued strong economic performance, and that annual GDP growth could surpass the original projection of 5.5% in 2003. Wijewardena also noted that as the country's macroeconomic fundamentals improve, the Government would seek a sovereign rating in early 2004. The Central Banker warned, however, that growth in the current 5-6% rate would be insufficient in the medium and long term to overcome basic economic problems such as poverty, malnutrition and unemployment. Wijewardena remarked that higher growth expected from 2004 onwards would require greater investment. This will depend on peace as well as speedy implementation of structural reforms, effective utilization of foreign assistance, infrastructure development, further improvements in macro economic management and reducing economic policy uncertainties. The Central Bank also warned against inflationary pressure from wage hikes that are not linked to productivity.

6. **Comment:** Overall the economic news continues to be good, with the GSL's economic reform and fiscal discipline reaping rewards in the form of improved economic performance. Employment continues to be an area of concern, however, with the PM and other key

officials urging private sector representatives to create jobs. While growth still remains below the 8-9 percent level that denotes "tiger" status, continued progress on economic reforms by the government, and a continued global economic rebound, could help pull Sri Lanka up to that vaunted level. End Comment.

ENTWISTLE